

§ 240.17a-12

(2) Transmit a report in accordance with paragraph (g) of this section within 48 hours of the notice stating what the broker or dealer has done or is doing to correct the situation.

(f) Every national securities exchange or national securities association that learns that a member broker or dealer has failed to send notice or transmit a report as required by paragraphs (b), (c), (d), or (e) of this section, even after being advised by the securities exchange or the national securities association to send notice or transmit a report, shall immediately give notice of such failure in accordance with paragraph (g) of this section.

(g) Every notice or report required to be given or transmitted by this section shall be given or transmitted to the principal office of the Commission in Washington, D.C., the regional or district office of the Commission for the region or district in which the broker or dealer has its principal place of business, the designated examining authority of which such broker or dealer is a member, and the Commodity Futures Trading Commission if the broker or dealer is registered as a futures commission merchant with such Commission. For the purposes of this section, "notice" shall be given or transmitted by telegraphic notice or facsimile transmission. The report required by paragraphs (d) or (e)(2) of this section may be transmitted by overnight delivery.

(h) Other notice provisions relating to the Commission's financial responsibility or reporting rules are contained in § 240.15c3-1(a)(6)(iv)(B), § 240.15c3-1(a)(6)(v), § 240.15c3-1(a)(7)(iv), § 240.15c3-1(c)(2)(x)(B)(I), § 240.15c3-1(c)(2)(x)(F)(3), § 240.15c3-1(e), § 240.15c3-1d(c)(2), § 240.15c3-3(i), § 240.17a-5(h)(2), and § 240.17a-12(f)(2).

(i) The provisions of this section shall not apply to a broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78o(b)(11)(A)) that is not a member of either a national securities exchange pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or a national securities association registered pursuant to sec-

17 CFR Ch. II (4-1-03 Edition)

tion 15A(a) of the Act (15 U.S.C. 78o-3(a)).

[58 FR 37657, July 13, 1993, as amended at 59 FR 5945, Feb. 9, 1994; 63 FR 59401, Nov. 3, 1998; 67 FR 58300, Sept. 13, 2002]

§ 240.17a-12 Reports to be made by certain OTC derivatives dealers.

(a) *Filing of quarterly reports.* (1) This paragraph (a) shall apply to every OTC derivatives dealer registered pursuant to Section 15 of the Act (15 U.S.C. 78o).

(i) Every OTC derivatives dealer shall file Part IIB of Form X-17A-5 (§ 249.617 of this chapter) within 17 business days after the end of each calendar quarter and within 17 business days after the date selected for the annual audit of financial statements where said date is other than the end of the calendar quarter.

(ii) Upon receiving from the Commission written notice that additional reporting is required, an OTC derivatives dealer shall file monthly, or at such times as shall be specified, Part IIB of Form X-17A-5 (§ 249.617 of this chapter) and such other financial or operational information as shall be required by the Commission.

(2) The reports provided for in this paragraph (a) shall be considered filed when received at the Commission's principal office in Washington, DC. All reports filed pursuant to this paragraph (a) shall be deemed to be confidential.

(3) Upon written application by an OTC derivatives dealer to the Commission, the Commission may extend the time for filing the information required by this paragraph (a). The written application shall be filed with the Commission at its principal office in Washington DC.

(b) *Annual filing of audited financial statements.* (1)(i) Every OTC derivatives dealer registered pursuant to Section 15 of the Act (15 U.S.C. 78o) shall file annually, on a calendar or fiscal year basis, a report which shall be audited by a certified public accountant. Reports filed pursuant to this paragraph (b) shall be as of the same fixed or determinable date each year, unless a change is approved in writing by the Commission.

(ii) An OTC derivatives dealer succeeding to and continuing the business

of another OTC derivatives dealer need not file a report under this paragraph (b) as of a date in the fiscal or calendar year in which the succession occurs if the predecessor OTC derivatives dealer has filed a report in compliance with this paragraph (b) as of a date in such fiscal or calendar year.

(2) The annual audit report shall contain a Statement of Financial Condition (in a format and on a basis which is consistent with the total reported on the Statement of Financial Condition contained in Form X-17A-5 (§ 249.617 of this chapter), Part IIB, a Statement of Income, a Statement of Cash Flows, a Statement of Changes in Stockholders' or Partners' or Sole Proprietor's Equity, and a Statement of Changes in Liabilities Subordinated to Claims of General Creditors. Such statements shall be in a format which is consistent with such statements as contained in Form X-17A-5 (§ 249.617 of this chapter), Part IIB. If the Statement of Financial Condition filed in accordance with instructions to Form X-17A-5 (§ 249.617 of this chapter), Part IIB, is not consolidated, a summary of financial data for subsidiaries not consolidated in the Part IIB Statement of Financial Condition as filed by the OTC derivatives dealer shall be included in the notes to the consolidated statement of financial condition reported on by the certified public accountant. The summary financial data shall include the assets, liabilities, and net worth or stockholders' equity of the unconsolidated subsidiaries.

(3) Supporting schedules shall include, from Part IIB of Form X-17A-5 (§ 249.617 of this chapter), a Computation of Net Capital under § 240.15c3-1.

(4) A reconciliation, including appropriate explanations, of the Computation of Net Capital under § 240.15c3-1 contained in the audit report with the broker's or dealer's corresponding unaudited most recent Part IIB filing shall be filed with the report when material differences exist. If no material differences exist, a statement so indicating shall be filed.

(5) The annual audit report shall be filed not more than sixty days after the date of the financial statements.

(6) Two copies of the annual audit report shall be filed at the Commission's principal office in Washington, DC.

(c) *Nature and form of reports.* The financial statements filed pursuant to paragraph (b) of this section shall be prepared and filed in accordance with the following requirements:

(1) An audit shall be conducted by a certified public accountant who shall be in fact independent as defined in paragraph (f) of this section, and it shall give an opinion covering the statements filed pursuant to paragraph (b) of this section.

(2) Attached to the report shall be an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation, the financial statements and schedules are true and correct and neither the OTC derivatives dealer, nor any partner, officer, or director, as the case may be, has any significant interest in any counterparty or in any account classified solely as that of a counterparty. The oath or affirmation shall be made before a person duly authorized to administer such oaths or affirmations. If the OTC derivatives dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; or if a corporation, by a duly authorized officer.

(3) All of the statements filed pursuant to paragraph (b) of this section shall be confidential except that they shall be available for use by any official or employee of the United States or by any other person to whom the Commission authorizes disclosure of such information as being in the public interest.

(d) *Qualification of accountants.* The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the State of his principal office.

(e) *Designation of accountant.* (1) Every OTC derivatives dealer shall file no later than December 10 of each year with the Commission's principal office in Washington, DC a statement indicating the existence of an agreement, dated no later than December 1 of that

year, with a certified public accountant covering a contractual commitment to conduct the OTC derivatives dealer's annual audit during the following calendar year.

(2) If the agreement is of a continuing nature, providing for successive yearly audits, no further filing is required. If the agreement is for a single audit, or if the continuing agreement previously filed has been terminated or amended, a new statement must be filed by the required date.

(3) The statement shall be headed "Notice pursuant to § 240.17a-12(e)" and shall contain the following information:

(i) Name, address, telephone number, and registration number of the OTC derivatives dealer;

(ii) Name, address, and telephone number of the certified public accounting firm; and

(iii) The audit date of the OTC derivatives dealer for the year covered by the agreement.

(4) Notwithstanding the date of filing specified in paragraph (e)(1) of this section, every OTC derivatives dealer shall file the notice provided for in paragraph (e) of this section within 30 days following the effective date of registration as an OTC derivatives dealer.

(f) *Independence of accountant.* A certified public accountant shall be independent in accordance with the provisions of § 210.2-01(b) and (c) of this chapter.

(g) *Replacement of accountant.* (1) An OTC derivatives dealer shall file a notice that must be received by the Commission's principal office in Washington, DC not more than 15 business days after:

(i) The OTC derivatives dealer has notified the certified public accountant whose opinion covered the most recent financial statements filed under paragraph (b) of this section that the certified public accountant's services will not be utilized in future engagements; or

(ii) The OTC derivatives dealer has notified a certified public accountant who was engaged to give an opinion covering the financial statements to be filed under paragraph (b) of this section that the engagement has been terminated; or

(iii) A certified public accountant has notified the OTC derivatives dealer that it will not continue under an engagement or give an opinion covering the financial statements to be filed under paragraph (b) of this section; or

(iv) A new certified public accountant has been engaged to give an opinion covering the financial statements to be filed under paragraph (b) of this section without any notice of termination having been given to or by the previously engaged certified public accountant.

(2) Such notice shall state the date of notification of the termination of the engagement of the former certified public accountant or the engagement of the new certified public accountant, as applicable, and the details of any disagreements existing during the 24 months (or the period of the engagement, if less) preceding such termination or new engagement relating to any matter of accounting principles or practices, financial statement disclosure, auditing scope or procedure, or compliance with applicable rules of the Commission, which disagreements, if not resolved to the satisfaction of the former certified public accountant, would have caused the former certified public accountant to make reference to them in connection with the report on the subject matter of the disagreements. The disagreements required to be reported in response to the preceding sentence include both those resolved to the former certified public accountant's satisfaction and those not resolved to the former certified public accountant's satisfaction. Disagreements contemplated by this section are those that occur at the decision-making level (*i.e.*, between principal financial officers of the OTC derivatives dealer and personnel of the certified public accounting firm responsible for rendering its report). The notice shall also state whether the certified public accountant's report on the financial statements for any of the past two years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles, and describe the nature of each such adverse opinion, disclaimer of opinion, or qualification. The OTC derivatives dealer shall also

request the former certified public accountant to furnish the OTC derivatives dealer with a letter addressed to the Commission stating whether the former certified public accountant agrees with the statements contained in the notice of the OTC derivatives dealer and, if not, stating the respects in which the former certified public accountant does not agree. The OTC derivatives dealer shall file three copies of the notice and the certified public accountant's letter, one copy of which shall be manually signed by the sole proprietor, or a general partner or a duly authorized corporate officer, as appropriate, and by the certified public accountant.

(h) *Audit objectives.* (1) The audit shall be made in accordance with U.S. Generally Accepted Auditing Standards and shall include a review of the accounting system, the internal accounting controls, and procedures for safeguarding securities including appropriate tests thereof for the period since the date of the prior audited financial statements. The audit shall include all procedures necessary under the circumstances to enable the certified public accountant to express an opinion on the statement of financial condition, results of operations, cash flows, and the Computation of Net Capital under § 240.15c3-1. The scope of the audit and review of the accounting system, the internal accounting controls, and procedures for safeguarding securities shall be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in the following are disclosed:

- (i) The accounting system;
- (ii) The internal accounting controls; and
- (iii) The procedures for safeguarding securities.

(2) A material inadequacy in the accounting system, internal accounting controls, procedures for safeguarding securities, and practices and procedures referred to in paragraph (h) (1) of this section that must be reported under these audit objectives includes any condition which has contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to:

(i) Inhibit an OTC derivatives dealer from promptly completing securities transactions or promptly discharging its responsibilities to counterparties, other brokers and dealers, or creditors;

(ii) Result in material financial loss;

(iii) Result in material misstatements of the OTC derivatives dealer's financial statements; or

(iv) Result in violations of the Commission's recordkeeping or financial responsibility rules to an extent that could reasonably be expected to result in the conditions described in paragraphs (h)(2)(i), (ii), or (iii) of this section.

(i) *Extent and timing of audit procedures.* (1) The extent and timing of audit procedures are matters for the certified public accountant to determine on the basis of its review and evaluation of existing internal controls and other audit procedures performed in accordance with U.S. Generally Accepted Auditing Standards and the audit objectives set forth in paragraph (h) of this section.

(2) If, during the course of the audit or interim work, the certified public accountant determines that any material inadequacies exist in the accounting system, internal accounting controls, procedures for safeguarding securities, or as otherwise defined in paragraph (h)(2) of this section, then the certified public accountant shall call it to the attention of the chief financial officer of the OTC derivatives dealer, who shall inform the Commission by telegraphic or facsimile notice within 24 hours thereafter as set forth in § 240.17a-11(e) and (g). The OTC derivatives dealer shall also furnish the certified public accountant with a copy of said notice to the Commission by telegram or facsimile within the same 24 hour period. If the certified public accountant fails to receive such notice from the OTC derivatives dealer within that 24 hour period, or if the certified public accountant disagrees with the statements contained in the notice of the OTC derivatives dealer, the certified public accountant shall inform the Commission by report of material inadequacy within 24 hours thereafter as set forth in § 240.17a-11(g). Such report from the certified public accountant shall, if the OTC derivatives dealer

failed to file a notice, describe any material inadequacies found to exist. If the OTC derivatives dealer filed a notice, the certified public accountant shall file a report detailing the aspects, if any, of the OTC derivatives dealer's notice with which the certified public accountant does not agree.

(j) *Accountant's report, general provisions*—(1) *Technical requirements.* The certified public accountant's report shall be dated; be signed manually; indicate the city and state where issued; and identify without detailed enumeration the financial statements and schedules covered by the report.

(2) *Representations as to the audit.* The certified public accountant's report shall state that the audit was made in accordance with U.S. Generally Accepted Auditing Standards; state whether the certified public accountant reviewed the procedures followed for safeguarding securities; and designate any auditing procedures deemed necessary by the certified public accountant under the circumstances of the particular case that have been omitted, and the reason for their omission. Nothing in this section shall be construed to imply authority for the omission of any procedure which certified public accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required under this section.

(3) *Opinion to be expressed.* The certified public accountant's report shall state clearly the opinion of the certified public accountant:

(i) In respect of the financial statements and schedules covered by the report and the accounting principles and practices reflected therein; and

(ii) As to the consistency of the application of the accounting principles, or as to any changes in such principles which have a material effect on the financial statements.

(4) *Exceptions.* Any matters to which the certified public accountant takes exception shall be clearly identified, explained, and, to the extent practicable, the effect of each such exception on the related financial statements shall be provided.

(5) *Definitions.* For the purpose of this section, the terms *audit* (or *examination*), *accountant's report*, and *certified*

shall have the meanings given in § 210.1-02 of this chapter.

(k) *Accountant's report on material inadequacies and reportable conditions.* The OTC derivatives dealer shall file concurrently with the annual audit report a supplemental report by the certified public accountant describing any material inadequacies or any matter that would be deemed to be a reportable condition under U.S. Generally Accepted Auditing Standards that are unresolved as of the date of the certified public accountant's report. The report shall also describe any material inadequacies found to have existed since the date of the previous audit. The supplemental report shall indicate any corrective action taken or proposed by the OTC derivatives dealer with regard to any identified material inadequacies or reportable conditions. If the audit did not disclose any material inadequacies or reportable conditions, the supplemental report shall so state.

(l) *Accountant's report on management controls.* The OTC derivatives dealer shall file concurrently with the annual audit report a supplemental report by the certified public accountant indicating the certified public accountant's opinion on the OTC derivatives dealer's compliance with its internal risk management controls. The procedures are to be performed and the report is to be prepared in accordance with U.S. Generally Accepted Auditing Standards.

(m) *Accountant's report on inventory pricing and modeling.* (1) The OTC derivatives dealer shall file concurrently with the annual audit report a supplemental report by the certified public accountant indicating the results of the certified public accountant's review of the broker's or dealer's inventory pricing and modeling procedures. This review shall be conducted in accordance with procedures agreed to by the OTC derivatives dealer and by the certified public accountant conducting the review. The purpose of the review is to confirm that the pricing and modeling procedures relied upon by the OTC derivatives dealer conform to the procedures submitted to the Commission as part of its OTC derivatives dealer application, and that the procedures

Securities and Exchange Commission

§ 240.17a-13

comply with the qualitative and quantitative standards set forth in § 240.15c3-1f.

(2) The agreed-upon procedures are to be performed and the report is to be prepared in accordance with U.S. Generally Accepted Attestation Standards.

(3) Every OTC derivatives dealer shall file prior to the commencement of the initial review, the procedures to be performed pursuant to paragraph (m)(1) of this section with the Commission's principal office in Washington, DC. Prior to the commencement of each subsequent review, every OTC derivatives dealer shall file with the Commission's principal office in Washington, DC notice of changes in the agreed-upon procedures.

(n) *Extensions and exemptions.* Upon the written request of the OTC derivatives dealer, or on its own motion, the Commission may grant an extension of time or an exemption from any of the requirements of this section either unconditionally or on specified terms and conditions.

(o) *Notification of change of fiscal year.*

(1) In the event any OTC derivatives dealer finds it necessary to change its fiscal year, it must file a notice of such change with the Commission's principal office in Washington, DC.

(2) Such notice shall contain a detailed explanation of the reasons for the change. Any change in the filing period for the audit report must be approved by the Commission.

(p) *Filing requirements.* For purposes of filing requirements as described in § 240.17a-12, these filings shall be deemed to have been accomplished upon receipt at the Commission's principal office in Washington, DC.

[63 FR 59401, Nov. 3, 1998]

§ 240.17a-13 Quarterly security counts to be made by certain exchange members, brokers, and dealers.

(a) This section shall apply to every member of a national securities exchange who transacts a business in securities directly with or for others than members of a national securities exchange, every broker or dealer (other than a member) who transacts a business in securities through the medium of any member of a national securities exchange, and every broker or dealer

registered pursuant to section 15 of the Act; except that a broker or dealer meeting all of the following conditions shall be exempt from the provisions of this section:

(1) His dealer transactions (as principal for his own account) are limited to the purchase, sale, and redemption of redeemable shares of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company; except that a broker or dealer transacting business as a sole proprietor may also effect occasional transactions in other securities for his own account with or through another registered broker-dealer;

(2) His transactions as broker (agent) are limited to:

(i) The sale and redemption of redeemable securities of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company;

(ii) The solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; and

(iii) The sale of securities for the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies; and

(3) He promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers.

Notwithstanding the foregoing, this rule shall not apply to any insurance company which is a registered broker-dealer, and which otherwise meets all of the conditions in paragraphs (a)(1), (2), and (3) of this section, solely by reason of its participation in transactions that are a part of the business of insurance, including the purchasing, selling, or holding of securities for or on behalf of such company's general and separate accounts.

(b) Any member, broker, or dealer who is subject to the provisions of this rule shall at least once in each calendar quarter-year: